

THE BIG PICTURE

Regulating Return Preparers: A Global Problem for the IRS

by Allison Christians



Allison Christians is the H. Heward Stikeman Chair in Tax Law at McGill University in Montreal, where she writes and teaches in the area of national and international tax law and policy. You can follow her on the Tax, Society & Culture blog at taxpol.blogspot.com or on Twitter @taxpolblog.

The IRS recently announced that its mandatory registration regime for paid tax return preparers would henceforth be offered as a voluntary program. The move follows the U.S. District Court of Appeals decision in *Loving v. IRS*, Dkt. 13-5061 (D.C. Cir. 2014). (Prior coverage: *Tax Notes*, Feb. 24, 2014, p. 809.) Commissioner John Koskinen expressed his hope that Congress will act soon to grant the agency the requisite power to make the program mandatory again. As National Taxpayer Advocate Nina Olson noted, regulation is needed because the evidence suggests local tax preparers are engaged in rampant error and fraud. (Prior analysis: *Tax Notes*, May 13, 2013, p. 767.) The program is thus laudable in its core animating ideal: Anyone paid to prepare tax returns for U.S. taxpayers ought to be both capable and accountable. But bear in mind how expansive the word “anyone” really is when it comes to the U.S. tax system.

For the IRS, thinking locally is always acting globally. In the business of tinkering with the U.S. tax code, it appears that both the lawmakers and the enforcers sometimes forget that the United States, alone in the world, permanently taxes nonresident citizens and

green card holders as if they were resident. That means that every attempt to regulate U.S. taxpayers is an international effort, and every attempt to regulate their assistants and advisers must be global in scope as well.

There is a deep mischief at work here. The tradition of “citizenship taxation” (a misnomer given that many nonresident noncitizens are captured within the concept) dates back to the Revenue Act of 1861, enacted to fund the Civil War. That was a time when citizenship was considered an exclusive status so that it nearly always overlapped with one’s actual residence and the few, typically temporary, exceptions to that rule were manageable. But subsequent income tax acts have continued the tradition of citizenship taxation through today. Over the years, this tradition has become increasingly misaligned with international norms and practices. It is also wholly inconsistent with global mobility and shifts in conceptions around citizenship, including the historically unprecedented possibility of dual and even multiple nationality. With the ever-growing complexity of the U.S. tax system and its suspicious attitude to all things foreign, the choice to hold on to citizenship taxation today presents nothing short of an extraterritorial tax enforcement nightmare.

Inescapably Global

All those who study citizenship taxation with any diligence acknowledge that it is simply unworkable at best. Most also conclude that it is an exercise in simple injustice at worst. But until Congress or the courts act, the IRS is seemingly duty-bound to press forward in its administration of a tax regime that reaches into every country, every possession and territory, every special administrative region, and every atoll in the world — enforcing its reach over U.S. persons wherever they may reside, over all of their sources of income, however and wherever derived.

This is a massive system to administer. History proves it cannot be accomplished without considerable assistance, namely from other governments. One need only briefly consult the Foreign Account Tax Compliance Act to understand what it takes to track the movements and income-related activities of a taxpayer population that spans the globe. It is a worldwide project requiring and relying on the intensive help of outsiders for success. As human mobility increases, together with the intricacy and interdependency of the global economic and financial system, the project of citizenship taxation can only become increasingly expansive and increasingly problematic.

This suggests that global enforcement is a tall order for the IRS, adding to the difficulties already posed by the agency's ceaseless budgetary pressures. Any attempt to regulate foreign tax preparers, especially those who have no financial or personal connections with the United States, will require some very thoughtful and creative strategies.

Controlling Behavior

The registered return preparer regime is in fact quite thoughtful and creative. But its thoughtful creativity is premised on an important assumption about the state's ability to control human behaviors. The assumption is that everyone who would fill out a tax return for a U.S. taxpayer is someone whose behavior the IRS can control through threats of professional discipline, fines, and imprisonment. If none of those punishments can be administered, things start to fall apart quickly. Yet this is very likely the situation for many foreign individuals who prepare U.S. tax returns for a local client base outside the United States.

To see why this might be so, consider the various obligations that currently apply to paid return preparers under statute and regulation, and those that will apply under the registration regime if Congress responds to the pleas of the IRS commissioner. Some of these obligations are considered onerous; some less so. All are ultimately backed up by the threat of force just as any law is. This threat ostensibly applies to persons outside the U.S. jurisdiction, but it isn't clear how such a threat can be carried out without disturbing some fairly well-established ideas about states and their authority to regulate. It is not difficult to compile a list of unknowns about how much power the IRS could possibly amass to control a rogue tax return preparer located permanently outside the U.S. territory.

A Range of Obligations

Under the authority of existing law, the IRS requires all paid return preparers to pay an annual fee (currently, renewal costs \$63) for a preparer tax identification number, and to include this number on all returns prepared for a fee. Paid return preparers are also subject to a set of governing statutes, including section 6694, which contains various disclosure rules; section

6695, which deals with furnishing taxpayers copies of returns and handling tax refunds; section 6713, which deals with how preparers may use information they obtain while preparing returns; and many others.

Most of these rules advise tax return preparers to refrain from various fraudulent and abusive behaviors. The registration process (in its mandatory version) would require would-be paid preparers to undertake specific actions as well. This includes passing an initial competency test and taking annual continuing education courses under the supervision and oversight of the IRS. Registered tax return preparers would also be subject to ethics rules laid out in Circular 230, which currently apply only to those who practice before the IRS.

Thus, the statutory regime and the regulation program attempt to forbid some behaviors and compel others. This presents distinct enforcement issues that carry interesting and difficult challenges as the control must be worldwide in order to be effective.

The Problem of Detection

The first and most obvious problem of applying rules that forbid behavior, even in a purely local context, lies in the detection of a prohibited action. In the case of return preparer error and fraud, detection is severely hampered by taxpayer ignorance. This translates to IRS ignorance about the facts and circumstances of the return preparer's involvement in the return. For example, an unscrupulous paid preparer may well try to avoid any cumbersome regulation by simply preparing returns for money but not signing them as such. An incompetent preparer may neglect to do so and make other errors that simply escape the taxpayer's notice. Somewhere between fraud and incompetence lies an ocean of individual decision-making about tax reporting that can only be sorted out by regular and diligent oversight.

In her 2013 annual report to Congress, Olson calls for a "consumer protection campaign" on the grounds that regulating tax return preparers requires educating taxpayers about the rules. Of course, this would have to be a global campaign, as an unsuspecting taxpayer in a foreign country can certainly be expected to be less than vigilant about the universe of rights and responsibilities encapsulated in the "Paid Preparer Use Only" portion of Form 1040. This is especially the case for a U.S. person whose obligation to file annual returns in the United States is newly revealed as FATCA comes into effect.

Elsewhere in her annual report, Olson points out that U.S. persons who live permanently in other countries are woefully uneducated and underserved by the IRS. We may add continued ignorance about the obligations of tax return preparers to a growing list of problems created by citizenship taxation that are unlikely to be resolved any time soon. It is simply the case that many U.S. persons have no idea how the U.S. tax system works. They also have no idea whether

their tax return preparers know better than they do, and they are vulnerable to fraud and error as a result.

Anecdotal evidence, supported by informed observation by Olson and many others, suggests very low understanding about the U.S. tax system within the United States itself. There is no reason to expect any greater enlightenment elsewhere. Within the United States, there is a realistic chance that fraudulent and incompetent return preparers can ultimately be discovered, and then prevented from exploiting the ignorance of others, using the civil and criminal law system in its current form. Outside of the United States, that chance looks much slighter, and it also looks much more difficult in terms of international relations. FATCA is poised to bring awareness about annual U.S. filing obligations to millions of nonresident U.S. persons, but it tells them nothing about how to fulfill those obligations. Once they start trying to comply, we should expect the size and scope of the detection problem to increase exponentially.

The Problem of Logistics

When the tax return preparer population includes potentially thousands or even hundreds of thousands of foreign individuals, compelling individual return preparers to act also takes on a technical dimension that regulators may well underestimate. For instance, the registration program's initial competency test requirement led the IRS to an apparently overwhelmingly challenging regulatory environment, flowing from the simple problem of geographic dispersion of the target population.

A private test administration vendor, Prometric Inc., was to give the initial competency test. In a "Candidate Information Bulletin" designed to assist return preparers in fulfilling the testing requirement, the IRS merely explained that "[t]ests are administered via computer at Prometric test centers," and guided readers to the IRS website for test center locations. Prometric's own website proudly proclaims its ability to conduct worldwide testing, with approximately 10,000 test centers in more than 160 countries. Yet the IRS website explains that Prometric "is currently offering the competency test in selected cities in the United States," that the IRS was "continuing to work on details for testing preparers living outside of the U.S.," and that "preparers living outside the U.S. will have a reasonable period of time to take and pass the test" once the IRS has "finalized the details."

When the mandatory aspect of the program was canceled in 2013, these details were still not finalized. One can only imagine the reaction of any foreign tax preparer who heard about the new mandatory regulation regime and read the explanation on the IRS website. We might wish to believe that from November 2011 through January 2013, foreign tax preparers rushed to the United States to take initial competency tests before assisting their local clients with their U.S. tax returns. Instead, it's much more likely that most

knew little to nothing of the requirements and therefore made little or no effort to comply.

But even of those who knew of the requirements, it is difficult to guess how many would be discouraged by the hassle and expense involved in complying. According to the plaintiffs in *Loving*, the population of unregulated return preparers includes individuals who assist a small number of long-term clients, friends, or an under-resourced community, for modest fees. When these preparers are not in the United States, time and travel costs may become prohibitive in themselves but there are also other barriers to entry, including visa restrictions. If it seems unlikely that this could be a real problem, consider that by some estimates, a population of 350,000 U.S. persons live in Brazil, more than 300,000 in the Philippines, some 100,000 in China, and thousands more in other places from which travel to the United States is not a straightforward or easy matter.

With a globally dispersed U.S. taxpaying population, it is likely that at least some are trying to fulfill their filing requirements with the help of local tax return preparers. These preparers may be far removed from the reach of the IRS, even if their clients are not. Geographic limitations present even willing foreign return preparers with formidable compliance barriers. One can only speculate why the clearly international service offered by Prometric was not employed to its maximum effect. As individual compliance efforts increase, so does the problem of regulating those who offer assistance for pay, regardless of credentials, experience, or intent to study the U.S. tax code in all its glorious complexity.

Fortunately for the strained resources of the IRS, but perhaps unfortunately for the untold thousands of U.S. persons abroad, unregulated tax return preparers can simply opt out of the registration program, loosening the reins of any IRS oversight. Across the world, just as in the United States, Olson's description is perfectly apt: We are in "the wild, wild west of tax return preparation." It seems likely that most unregulated foreign tax return preparers will remain at that frontier, staying unregulated for as long as they can, to avoid the cost that is associated with being regulated. But that still leaves the problem of enforcing sections 6694, 6695, 6713, 7201, and so on, on a global basis.

Crime and Punishment

Consider the penalties that potentially apply to paid return preparers, even in the absence of a registration program. Noncompliance can carry monetary penalties ranging from a modest \$50 (the low end for failure to include a PTIN on a return) to a not-so-modest \$500,000 (the high end for "wilfully attempt[ing] in any manner to evade or defeat any tax") per occurrence. Repeated noncompliance ultimately carries non-monetary penalties including felony conviction and imprisonment of up to five years per occurrence.

When the individual is physically beyond the sovereign territory and holds no domestic assets or accounts, exacting penalties involves some fairly serious enforcement action on the part of the IRS. Laws that strictly limit assistance in tax collection efforts among sovereign states clearly hamper IRS efforts to place liens and seize assets in other countries. Despite signing a multilateral agreement that would dismantle some of these age-old traditions, the United States has not yet committed to assist other countries in their enforcement efforts involving assets and accounts located in the U.S. The United States must, however, be interested in obtaining collection assistance from other governments (otherwise, the global data structure produced by FATCA appears to be pointless). FATCA may not reach the tax return preparer in any event, but even if it did, it wouldn't solve the collection problem because it is still primarily an information regime. More rules will have to be changed if the IRS is going to be able to collect on any tax-related penalties it assesses on foreign-located U.S. persons, let alone their foreign tax return preparers.

The ways and means of regulating paid return preparers demonstrate the difference between law on the books and law in practice. It is one thing to write a rule that says persons shall do or not do some things, but it is another to exact punishments for acts of commission or omission when the wrongdoer lives under the jurisdiction of another sovereign. Punishments outlined in U.S. law for actions carried out wholly outside the United States are toothless unless something can be done to ensure the global reach of civil and criminal enforcement mechanisms. Under a citizenship taxation regime, taxpayer protection necessarily involves exerting jurisdiction over all those who would potentially fill out U.S. tax returns from Afghanistan to Zimbabwe and every place in between.

For U.S. taxpayers, working with the world's most complex tax code is a burdensome task. As Olson points out, the vast majority seek help with annual filing out of necessity and fear of getting things wrong. For U.S. taxpayers who do not live in the United States and whose lives play out in the international sections of the tax code, both necessity and fear are enhanced. International taxpayers face more penalties, even for unwitting errors, than their domestically confined counterparts. The unregulated foreign return preparer is likely indisposed to presenting himself to the IRS for punishment, even if aware of a regulatory violation. If anything, U.S. persons living abroad deserve stronger protections than those whose return preparers can ultimately be brought to heel by local authorities.

Who Pays?

The likely victim of internationally committed fraud or incompetence is not the imagined wealthy American

expat living on a yacht in the Mediterranean. That person can afford to hire a qualified tax preparer. Instead, it will be one of the vast majority of lower- and middle-income U.S. persons overseas whose lives are — or soon will be — heavily burdened by U.S. citizenship taxation. The energy and ability of those individuals to find a reputable and knowledgeable tax return preparer who is also affordable (assuming such a person exists) is limited. While Olson may not specifically have had these unfortunate souls in mind when she called on the IRS to protect “easy targets for marketing schemes of unregulated and unqualified so-called return preparers,” they must be as entitled to that protection as any other U.S. taxpayer.

Of course, as demonstrated in the Government Accountability Office report that prompted the mandatory regulated return preparer regime in the first place, the other victim of unscrupulous and incompetent tax return preparers is the IRS itself. A limited capacity to audit understatements of income and tax makes the whole system vulnerable to widespread fraud and the crumbling taxpayer morale that accompanies it. IRS enforcement of foreign tax preparers is equally as important as its regulation of the domestic return preparation industry, both for the sake of the system itself and for the sake of its globally dispersed taxpayer population. The constant threats to downsize the IRS lead to grave doubts that the agency can fulfill its mandates for ever-broader enforcement schemes.

Conclusion

The IRS is in charge of a juggernaut of a tax system, the likes of which there truly is no equal in the world. And as all too often appears to be the case, in the enthusiasm to improve the functioning of this regime, its authors and enforcers appear to have forgotten that this unique system is perfectly global in reach, thanks to its unique inclusion of citizens and others with legal residence status no matter where in the world they live.

The problem of regulating all foreigners in service of U.S. citizenship taxation plagues FATCA in the details, and it will plague the project of tax return preparer regulation as well. It won't be easily solved unless Congress can accept that the universally practiced norm of residency-based taxation is really the only viable option in a globalized world. If not, as the world adjusts to the ongoing expansion of U.S. regulatory power through more — and more complex — financial regulation, everyone will have to accept that virtually every tax move Congress makes has global implications. ◆